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Notable Cases on Corporate Law

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*translated by JKL student editors***

I. The Person Who May Exercise Shareholder Rights in Relation to the Company: Supreme Court *en banc* Decision 2015Da248342 (Decided March 23, 2017)

1. Issues and Supreme Court Decision

The Plaintiff is recorded in the shareholder registry of the Defendant (a listed company in the securities market) as holding 2,604,300 shares. The Plaintiff claimed that the resolution of the appointment of a director made by the Defendant company's regular general shareholders' meeting on March 28, 2014 was defective. The main issue was whether the Plaintiff could exercise shareholder rights in relation to the Defendant company. The Plaintiff purchased exchange-traded shares issued by the Defendant using a securities account opened within a securities company under his name. However, the money which was actually paid to the aforementioned account was not the Plaintiff's, but belonged to a real shareholder (Nonparty).

The lower court rejected the lawsuit as lacking standing to sue, since the Plaintiff was only a borrower of title and therefore not in the status of a shareholder. The Supreme Court *en banc* decision reversed the lower court's decision, distinguishing between "the legal relationship between principals

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other than the company concerning the attribution of ownership of shares" and "the situation in which a shareholder exercises his shareholder rights in relation to the company" and, deciding that this issue was about the latter, changed its stance from the judicial precedent. The summary of the decision is as follows: ① "The legal principle determining shareholders entitled to vote in relation to the company based on the list of names that appear in the shareholder registry is also applicable in cases involving both the transfer and issuance of shares." ② "Only a person owning a company's shares and whose name appears in the register of shareholders may lawfully exercise voting rights in relation to the company. This is applicable in either of the following cases: if a company's shares have been transferred but the transferor remains as the shareholder on the register of shareholders due to entry of change not having been made; or if a person used another's name to purchase or transfer a company's shares and the borrowed name was subsequently entered in the register of shareholders." ③ "Inasmuch as the legal principle allowing only shareholders whose name is in a company's shareholder registry to exercise rights applies to both a company and its shareholders, a company – barring special circumstances – cannot either deny the exercise of rights by a shareholder whose name appears in the shareholder registry or acknowledge the exercise of rights by a shareholder whose name is not in the shareholder registry." Lastly, in summarizing the aforementioned legal principles, the Supreme Court concluded ④ "Barring special circumstances, a person owning a company's shares whose name is lawfully entered in the register of shareholders is entitled to vote on a matter presented at the general shareholders' meeting, and a company – regardless of whether being aware that there are those, other than shareholders whose name is in the shareholder registry, who intended to purchase or transfer shares – may neither deny the exercise of rights by shareholders whose name is in the shareholder registry nor acknowledge the exercise of rights by shareholders whose name has not yet been recorded therein."

On the other hand, in relation to the majority opinion, the concurring opinion views that the standing to sue of the Plaintiff – who met both the formal and substantive requirements – is acknowledged, since the Plaintiff can be seen as a shareholder even in the stage of deciding ownership attribution based on the facts of the case. It says that this case is regarding the transfer of listed stocks in which the person trying to obtain the stocks should open an account in a securities company, and financial transactions as such are subject to the Act on Real Name Financial Transactions and Confidentiality, so barring special circumstances, the funds deposited in an account in the Plaintiff's name belongs to the Plaintiff regardless of the source of those funds. In conclusion, the concurring opinion – although the reasoning is different – also saw that the Plaintiff who had finished the entry of a change of a holder was a rightful shareholder in every respect, acknowledging the Plaintiff's standing to sue like the majority opinion.

2. Comments

This is an *en banc* decision which, among recent decisions, has had the greatest impact on interpretations of corporate law. However, perhaps because the Supreme Court was not able to consider all of the various issues, the decision leaves some questionable areas. The *en banc* decision distinguished between "the attribution of share ownership" and "the exercise of shareholder rights in relation to the company" and focused on examining the latter. This division itself is acceptable since the Commercial Act sets separate the requisites for entry of a change of a holder in the register.

Among the main holdings, ① and ③ do not seem to raise any further questions. From the perspective of the exercise of shareholders' rights, it is not necessary to distinguish between subscription and acquisition of shares made in another person's name. As to ③, it was the common view and the judicial precedent that the company could acknowledge the exercise of rights by shareholders whose name had not yet been recorded in the shareholder registry (unilateral binding theory) because the Article 337(1) of the Commercial Act is formatted as "The effect of transfer of shares shall not be asserted against the company, unless the name and address of the transferee have been entered in the register of shareholders." However, since giving the company the right of choice could bring about unjust results, this decision ruled that even the company could not acknowledge the exercise of rights by shareholders whose name had not yet been recorded in the shareholder registry (change to bilateral binding theory).

Meanwhile, ② is persuasive because the scope of application is limited to (i) subscription made in other person's name + entry of a change of a holder made in other person's name, (ii) acquisition of shares in other person's name + entry of a change of a holder made in other person's name, (iii) shareholders whose name has not yet been recorded in the shareholder registry. The greatest basis for the argument is the intention of the principal of share subscription or acquisition (in other words, the real shareholder). When such intention is interpreted normatively, it can be seen that the holder of title is allowed to exercise shareholder rights at least in relation to the company.[1] Because this is a case in which there is agreement between the holder of title and the real holder of right about the subscription of shares and entry of a change of a holder, it is not unjust to acknowledge that only the holder of title may exercise shareholder rights in relation to the company.

However, the meaning of ④ is not clear. On the surface, it seems that as long as a shareholder's name is entered in the shareholder registry, that shareholder can exercise shareholder rights in relation to the company, and the company must recognize such rights even if it is aware of the shareholder's actual lack of rights. However, for instance, if one makes an entry of change in the register using lost share certificates, it is unjust to recognize such a person's rights even when the company knows about, and may easily prove, the situation. The Supreme Court also assumes that the entry of change was made lawfully. The text of the decision specifying "that there are those, other than shareholders whose name is in the shareholder registry, who intended to purchase or transfer shares" shows that the focus is on ②. This means that the point of the decision is that, in cases like ②, the company cannot either deny the exercise of rights by shareholders whose name is recorded in the shareholder registry or acknowledge the exercise of rights by shareholders whose name has not yet been entered therein even if the company knows of the internal legal relationship between the transferor and transferee. On the other hand, as in

1) The decision states, "If a person, entitled to vote on a matter presented at a company's meeting of general shareholders through a request for entry in the shareholder registry at any time, enters the registry thereof under another's name, then it is reasonable to either permit or accept the exercise of rights by those shareholders whose name appears in the company's shareholder registry."

the case of the aforementioned lost share certificates, illegal entries of change in the register by unentitled persons must be viewed as unlawful. Such entries of change are void, but the principle (and limits) of immunity due to entry of change should be applied to companies in good faith to protect legal stability. It is unclear which other cases should be counted as "lawfully entered in the register." For instance, one may consider the case where the entry of change in the name of the transferee is made, but the stock transaction is lawfully cancelled, and the stock ownership returns to the transferor. Should the transferee, whose name is in the register, be treated as the shareholder whether or not the company knows of the situation? It is doubtful whether this conclusion is correct or was intended by this decision.[2)] In reality, most cases in which entries of change in the register become problematic are related to ②. In the case of ②, it can be said that the parties of the transaction, at least normatively, accepted the mentioned effects, so the changed decision appears to be correct. The phrasing of ④ is problematic in that it may be interpreted as allowing persons other than in the case of ②, that is, persons unlawfully entered in the register, to exercise shareholder rights in relation to the company.[3)]

II. Hanwha Representative Suit: Supreme Court Decision 2015Da70044 (Decided September 12, 2017)

1. Issues and Supreme Court Decision

This was a case in which groups such as the Solidarity for Economic Reform filed a representative suit concerning allegations of unjust succession in Hanwha Group. On June 17, 2005, Hanwha Corporation ("Hanwha") held a meeting of its board of directors and sold to Nonparty X (the eldest son of Defendant A – Defendant A is the group head as well as

2) Here, the transferor technically does not fall under those "who intended to purchase or transfer shares" as the decision phrased.

3) The concurring opinion of this decision views the majority opinion as "deeming only a person whose name appears in the register of shareholders to effectively exercise rights, even if substantive rights are not attributed to such person."

a director of Hanwha and its biggest shareholder) all shares (400,000, or 66.7%) that it owned of Hanwha S&C Corporation ("Hanwha S&C") for 5,100 won per share. Hanwha S&C, a constituent of Hanwha Group which manages its IT network, required capital increase for value due to increasing liabilities since 2004 – a need which Hanwha, the parent company, was not fulfilling due to problems such as the ceiling on total equity investment. The Plaintiffs claimed that Defendant A and other directors of Hanwha who approved the above sale violated the prohibition of self-dealing and the prohibition of appropriation of company's opportunities under the Commercial Act and breached the directors' duty of care to the company regarding the sale price and etc.

The Supreme Court dismissed the Plaintiffs' claims. Firstly, ① regarding the prohibition of self-dealing, the Court recognized the scope of regulation itself broadly. That is, "barring special circumstances, transactions likely to either cause conflict of interest between a company and a director or bring undesirable outcomes for a company, such as where a director engages in a transaction with a company as a counterparty and/or a counterparty's proxy or representative, fall under 'transactions between a director and a company that require approval by the board of directors." However, for this specific case, the Court decided that, even if the transaction fell under self-trading, the directors could not be faulted since there had been approval by Hanwha's board of directors in accordance with Article 398 of the former Commercial Act with the material facts regarding the interested parties and the transaction being disclosed beforehand. ② Regarding the prohibition of appropriation of business opportunities, the Court judged this as a matter of a director's general duty of care or duty of loyalty to the company, taking into account there being no specific regulations regarding appropriation of company's opportunities.[4] The conclusion was that "even if Hanwha were to have passed up a lucrative business opportunity through the instant stock transaction that resulted in said opportunity going to Nonparty X (Defendant A's eldest son) who purchased the shares, insofar as Hanwha's board of directors had sufficiently gathered and analyzed information on the stock transaction before deciding on whether

4) The Commercial Act amended in 2011 created Article 397-2 for the prohibition of appropriation of company's opportunities and assets.

to approve such transaction based on due process, and there was no apparent irrationality in the board of directors' decision-making process, the Defendants cannot be deemed to have breached a director's duty of care or duty of loyalty." ③ Regarding the breach of duty of care or duty of loyalty regarding selling at inappropriately low price, the Supreme Court "deemed that there was a valid reason for Hanwha's disposal of the instant shares, and there were neither loopholes in ○○ Accounting Firm's process of assessing the value of the instant stocks nor doubts as to the assessment result; and accordingly, concluded that the resolution by the Defendants regarding the instant stock transaction could not be deemed as a director's neglect of duty." In conclusion, none of the Plaintiffs' claims were accepted.

2. Comment

This case is similar to the case of the Shinsegae representative suit, Supreme Court Decision 2011Da57869 (Decided September 12, 2013), in that civic organizations filed a representative suit which called into question the *chaebols*' expedient succession of wealth. The fact that the son of the company's head acquired shares of an affiliate within the group with a positive business outlook and that minority shareholders claimed the company's violation of the prohibition of self-dealing, the prohibition of appropriation of company's opportunities, and the prohibition of competitive business, which was rejected by the Court, are also common between the two cases.

In this case, the representative Plaintiff could not claim the Defendant's liability for damage further, since the Supreme Court affirmed the lawful approval of the board of directors and fairness of the trading price. Legally notable points are as follows. The Plaintiffs of the Shinsegae representative suit were the minority shareholders of Shinsegae Inc., and the Defendant was the son of Shinsegae Group's controlling shareholder as well as a director of Shinsegae Inc. On the other hand, in this case, the Defendant was the son of Hanwha Group but not a member of the board of directors of Hanwha Corporation (which was claimed to have suffered damage). Thus the son of the group head, who had succeeded controlling shares, was excluded from the Defendants in this case, unlike in the case of Shinsegae representative suit. It raised the issue whether Article 398 of the former

Commercial Act applies to a transaction which is not for the director's own interest but generates profit for the director's eldest son. In this case, the Supreme Court decided, "transactions likely to either cause conflict of interest between a company and a director or bring undesirable outcomes for a company fall under 'transactions between a director and a company that require approval by the board of the directors," thereby recognizing the scope of a director's self-dealing broadly. Considering that this decision was made under the former Commercial Act, there is room for debate regarding to what extent this abstract principle can be applied under the current Commercial Act which was amended in 2011 – which lists persons to whom its articles are applied, such as a major shareholder.

III. The Standard of Determining Subsidization for Affiliates and Occupational Breach of Trust: Supreme Court Decision 2015Do12633 (Decided November 9, 2017)

1. Issues and Supreme Court Decision

In this case, Defendant 1 – who was the former chairperson of SPP Group – and the major members of the group management support center's board of directors were charged with occupational breach of trust and embezzlement (more specifically, violation of the Act on the Aggravated Punishment, etc. of Specific Economic Crimes) regarding subsidization for affiliates. The major issue was whether Defendant 1's case fell under occupational breach of trust. In this case, the subsidizing companies within SPP Group were SPP Machine Tech, SPP Shipbuilding (62.9% shares held by SPP Machine Tech), and SPP Plant & Shipbuilding (100% shares held by SPP Shipbuilding). On the other hand, subsidized affiliates include SPP Yulchon Energy, a 100% subsidiary of SPP Plant & Shipbuliding. SPP Yulchon Energy was founded around January 2008 to manufacture forged products used in shipbuilding, nuclear, and wind power plants, in line with the group's strategy to develop new growth areas. Meanwhile, SPP Logics was also one of the subsidized companies, shares of which were 100% held by the second son of Defendant 1.

SPP Group's overall financial position was not good when the subsidization of affiliates occurred as the shipbuilding industry was deteriorating. In particular, SPP Shipbuilding, the main force affiliate, concluded financial structure improvement agreement and autonomous agreement with financial institutions around May 2010 because its financial condition had worsened due to foreign-exchange derivatives losses since 2008, and suffered capital erosion of KRW 250.1 billion by the end 2010. SPP Machine Tech, which could be called the Group's holding company, suffered capital erosion from KRW 46.9 to KRW 56.1 billion from the end of 2009 to 2011.

The main charges of occupational breach of trust against Defendant 1 was that he was involved in the following acts of subsidization. ① SPP Shipbuilding economically subsidized its affiliates including SPP Machine Tech, SPP Yulchon Energy, and SPP Steel Pipe in a large scale for a prolonged period of time in the form of concluding integrated purchase contracts on December 1, 2009 and supplying the steel it had purchased in advance on account receivables (integrated purchase). ② SPP Shipbuilding economically subsidized its affiliate SPP Steel Pipe – which was one of its accounts for scrap metals – in the form of supplying scrap metals on account receivables from the end of 2009 as it was experiencing financial difficulty (disposal of scrap metals). ③ SPP Machine Tech lent SPP Yulchon Energy KRW 75.8 billion from July 2010 to April 2012 (financial loans). ④ SPP Shipbuilding and SPP Plant & Shipbuilding subsidized SPP Machine Tech and SPP Yulchon Energy, in the form of making advance order of cranes for vessels from SPP Machine Tech and paying in advance, then SPP Machine Tech lending these funds to SPP Yulchon Energy (advance order). ⑤ SPP Plant & Shipbuilding lent SPP Logics KRW 18.3 billion from January 15, 2010 to April 23, 2010 (subsidization for SPP Logics).

While the lower court convicted Defendant 1 for most of the abovementioned charges and judged guilty, the Supreme Court reversed the lower court's decision regarding ① to ③. As a generality, the Supreme Court decided that "... in addition to the factors stated earlier, the determination whether a cross subsidization was conducted within the discretionary scope of reasonable business judgment requires consideration of the following factors: (a) whether the subsidizing and subsidized affiliates are practically combined in terms of capital and operation to such an extent that they are geared toward common interests and synergy effect; (b) whether such cross subsidization is for the sake of common interests of all the affiliates and subsidiaries of a business group including the subsidizing affiliate, and not just for the interests of a specific person or company; (c) whether the decisions on the designation of a subsidizing affiliate and the scale of subsidization were objectively and reasonably made by fully taking into account such factors as the given affiliate's intent and capacity to subsidize; (d) whether the specific subsidization was implemented by a normal and lawful method; and (e) whether the subsidizing affiliate could have objectively expected an adequate reward commensurate with the burden or risk attendant on the subsidization. If comprehensive consideration of all these factors leads to the recognition that the cross subsidization at issue was conducted within the discretionary scope of reasonable business judgment, then it is difficult to find it as an intentional act with the knowledge of detriment to the principal."

Specifically, ① it is difficult to conclusively deem the integrated purchase an intentional act of Defendant 1. Although SPP Shipbuilding, when the integrated purchase took place, was suffering from capital erosion on the accounting books, it is difficult to conclude that it lacked the capacity to support its subsidiaries, since it had realized KRW 21.8 billion in operating income in 2009, KRW 29.7 billion in 2010, and rolled over the derivatives' maturity. Additionally, the above support was for the sake of common interests of the subsidiaries engaging in identical or similar fields, and the choice of beneficiary and volume of support were within the scope of objective and reasonable standards. Also, it was objectively expected that the integrated purchase would bring expansion of the business on group-level, thereby realizing a synergetic effect. ② The Supreme Court also denied that the disposal of scrap metals was an intentional act of professional malpractice, pointing out the aforementioned basis of judgement: the supporting company's economic capability, common interests of the subsidiaries, and the expectation of a synergetic effect or future returns. ③ The Supreme Court ruled that the lower court should have divided the financial loans into those for which the intent of occupational breach of trust is recognized and those for which it is not. In particular, though SPP Plant & Shipbuilding suffered a considerable amount of capital erosion, it realized approximately KRW 7.1 billion in operating income in 2008 and KRW 10.1 billion in 2011. Maturity of derivatives, which caused the capital erosion, was postponed to the end of 2012. The Court also stressed that the financial subsidization of SPP Plant & Shipbuilding granted for SPP Yulchon Energy was subsidization by a parent company[5)]for its subsidiary. SPP Yulchon Energy, nurtured as a next-generation growth engine, was deemed to have a positive business outlook. In contrast, on ④ and ⑤, the Supreme Court affirmed the lower court judgement of finding Defendant 1 guilty of professional malpractice. ④ On the advance order, it ruled that the advance order and payment was made notwithstanding the lack of any real demand for cranes on vessels, which appears to have been an expedient means to bypass the prohibition against direct subsidization due to the autonomous agreement they entered into with the creditors, and thus from which appears to have been difficult to objectively expect reward or benefit commensurate with the indirect, secret subsidization. ⑤ It pointed out that the financial subsidization granted to SPP Logics was for the benefit of Defendant 1's second son, the 100% shareholder of SPP Logics.

2. Comment

This case demonstrates the tendency of the Supreme Court to limit the scope of breach of trust. It is inappropriate to find all acts of subsidization for affiliates suffering from financial difficulty to be a breach of trust. Subsidizing newly founded affiliates that are venturing into new business areas is necessary for the long-term growth of the entire group, for instance. The Court decision indicates five factors by which subsidization for affiliates is justified: (i) whether the subsidizing and subsidized affiliates are practically combined in terms of capital and operation, (ii) whether such cross subsidization is for the sake of common interests of all the affiliates and subsidiaries of a business group including the subsidizing affiliate, and

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5) At that time, the corporate governance hierarchy of the SPP group can be listed from above as such: SPP Machine Tech – SPP Shipbuilding – SPP Plant & Shipbuilding – SPP Yulchon Energy. Therefore, to be precise, SPP Machine Tech, the subsidizing affiliate, is a great-grand parent company of SPP Yulchon Energy, the subsidized affiliate.

not just for the interests of a specific person or company, (iii) whether the decisions on the designation of the subsidized affiliate and the scale of subsidization were objectively and reasonably made, (iv) whether the specific subsidization was implemented by a normal and lawful method, and (v) whether the subsidizing affiliate could have objectively expected an adequate reward out of the subsidy. ④ did not fulfill the factors (iii), (iv), and (v) and ⑤ did not meet (ii) and (iii). ⑤, in particular, is an expedient transfer of wealth by the group owner family which typically does not meet factor (ii).

It is also interesting to compare the aforementioned five factors with the six standards of *abus de biens sociaux*[6] of the French Commercial Code. Since 1985, *Cour de Cassation* applies the so-called "Rozenblum Doctrine" on inter-group transactions between affiliates. According to the doctrine, inter-affiliate transaction is justified, even when it inflicts financial loss to some of the affiliates, when the following four conditions are met: (a) all applicable companies must belong to one group which is characterized by capital links between the companies (unified system of command required), (b) there must be shared economic, social or financial interests on a policy designed for the entire group's benefit (not on pursuit of interest for a specific party), (c) the support from the subsidiary must not go beyond its financial capabilities, (d) the financial support from one company to another company must have an economic quid pro quo and may not break the balance of mutual commitments between the involved companies. These generally coincide with the factors that the Supreme Court listed above, except for factor (iv). However, considering that the Rozenblum Doctrine is still a subject of controversy in terms of its specificity, it remains to be seen whether those five factors will function as practical and predictable standards.

Lastly, the Supreme Court's decision stays in line with its conventional position which considers the problem a matter of intent rather than a

6) French Commercial Code Article L242-6 3° dictates that the chairman, directors or managing directors of a public limited company who use the company's property or credit in bad faith, in a way which they know is contrary to the interests of the company, for personal purposes or to encourage another company or undertaking in which they are directly or indirectly involved, shall be punished by a prison sentence of five years and a fine of 375,000 euros.

matter of the objective elements of embezzlement, even when the business judgements were made through appropriate procedures and requirements. However, when a director has fully performed his duty of care, it is valid to say that an objective element, “breach of occupational obligation,” was itself not fulfilled.